



Employee Benefit Plans

IRS Announces Major Qualified Plan Determination Letter Program Change Revenue Procedure 2016-37

The Internal Revenue Service has published very important new guidance on assuring employer sponsored pension and profit sharing plans qualify for tax exemption. Revenue Procedure 2016-37, 2016-29 Internal Revenue Bulletin, June 29, 2016.

The new IRS guidance includes a major change in IRS procedures, making it advisable for employers sponsoring individually designed qualified pension and profit sharing plans to reconsider how they administer, amend and confirm continued qualification of those plans.

This is because under the changes announced by the IRS an employer will no longer be able to periodically get and rely upon a favorable written determination letter from the IRS that a plan continues to meet legal requirements for tax favored qualification.

Plan Qualification Importance and Requirements

A key positive compensation and benefits feature of qualified pension and profit sharing plans is the tax exempt status of the trust maintained for investment of plan assets, combined with the current tax deduction by the employer of its contributions to the trust and deferral of income tax afforded to employees on plan benefits that accrue during active employment until distribution to them upon retirement.

The Internal Revenue Code and Income Tax Regulations under it provide that for this tax favored treatment to apply qualified plans must be established and operated in accordance with a written plan document that contains numerous specific terms and provisions, including provisions for participation by employees, and non-discrimination in, vesting and distribution of benefits.

If the terms and provisions of a pension or profit sharing plan do not contain and properly state all of these requirements, the tax exempt status of the plan may be denied, and unintended and unfavorable federal income tax effects may result for the trust of the plan, the employer and employees participating in the plan.

The regulations also provide, however, that under certain conditions a qualified plan can be amended within a certain period of time referred to as a “remedial amendment period” and a plan amendment can be made retroactive to comply with changes in these Code plan qualification requirements and thereby stay qualified for tax favored treatment.

For example, if a change in the Code qualification requirements is enacted in year 1, the regulations generally allow the employer to operate the plan in accordance with that change and subsequently amend the plan document terms and provisions retroactively in a remedial amendment period ending in year 2, without losing the plan's qualification for tax exemption.

The regulations under the Code allow the IRS to extend the remedial amendment period.

IRS Plan Qualification Determination Letters

The IRS published procedures currently in effect provide that an employer that establishes a plan intended to be qualified for tax exemption under the Code may submit an application to the IRS to review the plan and then issue a written determination to the employer that the plan as written meets all qualification requirements under the Code.

For a plan that has received such a favorable initial IRS determination letter, the present IRS procedures then also provide for a system of cyclical remedial amendment periods for individually designed plans. The rules effectively put each individually designed plan on a five (5) year remedial amendment cycle. This allows the employer sponsoring the plan to reapply for a new or updated favorable IRS determination letter once every five (5) years to cover changes in the Code qualification requirements applicable to the plan and conforming amendments made to the plan since it received the initial determination letter.

The year that a particular employer may request an updated IRS determination letter is determined based upon the employer identification number of the employer. The procedure is administered in "staggered 5-year remedial amendment cycles" for employers, with limited number of all employers sponsoring individually designed plans being authorized to file for a new determination letter in each year during a 5-year cycle. This has enabled employers and the IRS to avoid all employers sponsoring qualified plans having to submit an application for an updated favorable IRS determination letter at the same time after each new plan qualification requirement is enacted by Congress or added by new provisions in the regulations.

IRS Determination Letters after Initial Qualification Eliminated

In 2015, the IRS announced that it was considering making changes to its present employee plans determination letter program for qualified retirement plans.

Now, under the new IRS published guidance in Revenue Procedure 2016-37, the IRS has determined and announced that effective January 1, 2017, the staggered five (5) year remedial amendment cycles for applying for updated favorable IRS determination letters for individually designed plans will be eliminated.

The IRS determination letter program will now be limited to initial plan qualification, qualification upon plan termination, and certain other limited circumstances.

Effective January 1, 2017, a sponsor of an individually designed plan will be permitted to submit a determination letter application only for initial plan qualification, for qualification upon plan termination, and in certain other circumstances.

For disqualifying provisions that arise as a result of a change in qualification requirements, the IRS will annually publish a “Required Amendments List,” which will establish the deadline for a plan to be amended to comply with requirements. The deadline will generally be, unless otherwise provided, the end of the second calendar year following the year in which the list is issued.

Also, in general, a change to the qualification requirements will not appear on an IRS published Required Amendments List until guidance with respect to such change has been provided in regulations or in other IRS published guidance. The first Required Amendments List generally will apply to changes in qualification requirements that first become effective during the 2016 calendar year.

The new IRS guidance changing the plan qualification determination letter program also provides an extended remedial amendment period to correct disqualifying provisions that are in new plans, arise as a result of amendments made to existing plans, and arise as a result of a change in qualification requirements. And, for individually designed plans, a transition rule extends the remedial amendment period for certain disqualifying provisions to December 31, 2017.

Significant Effect and Planning

The new IRS guidance on determination letters for qualified plans creates uncertainty and adds potential complications for employers sponsoring qualified plans.

The process of amending plans to conform to changes in tax qualification requirements during the life span of a plan will no longer give an employer that is a plan sponsor the opportunity to receive and rely upon periodic written determinations by the IRS that all qualification requirements are being met by the plan.

The change may have indirect consequences or side effects extending beyond simply the question of the qualified status of a plan as between the plan sponsor and the IRS.

The fiduciary of a plan intended to be qualified for tax exemption likely has a legal duty to assure that the plan is written and operated to meet all applicable qualification requirements. As a plan fiduciary it may want or need to find an alternative means to periodically obtain some kind of written determination that can be relied upon to confirm the plan’s continuing qualified status.

Another issue may be in merger and acquisition transactions and how a pension or profit sharing plan of a business that is a party to such a transaction can be represented and confirmed to be qualified in the absence of any updating favorable IRS determination letters for the plan.

It is common for many employers that adopt qualified pension and profit sharing plans to maintain and administer them for many years following their application for and receipt of the IRS determination letter for initial plan qualification.

Therefore, this new IRS guidance certainly suggests careful attention be given to it by employers and that they should decide on and follow prudent alternatives by which they and other interested persons can obtain the same degree of assurance of a plan’s ongoing tax qualification as has been

provided by being able to periodically apply for and receive updated IRS favorable determination letters, the procedure for which will now no longer be available.

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